

**LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS**

301 State House
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FISCAL IMPACT STATEMENT

LS 7569

BILL NUMBER: HB 1981

NOTE PREPARED: Feb 7, 2003

BILL AMENDED:

SUBJECT: Health Benefit Plans; Tax Credit.

FIRST AUTHOR: Rep. Orentlicher

FIRST SPONSOR:

BILL STATUS: As Introduced

FUNDS AFFECTED: X

X

**GENERAL
DEDICATED
FEDERAL**

IMPACT: State & Local

Summary of Legislation: The bill provides a credit against state tax liability for a taxpayer that makes health insurance available to the taxpayer's employees through a cafeteria plan. It also provides that the credit equals the lesser of: (1) \$500; or (2) the result of \$200 plus \$10 multiplied by the number of employees exceeding 20. The bill requires an employer with at least 25 full-time employees to offer at least one health benefit plan. The bill also requires an employer to allow an employee: (1) to choose whether to participate in the plan; and (2) to pay the employee's cost of the plan through payroll deduction. It also permits an employer to pay or reimburse all or a part of the employee's cost to participate in the plan on an equal basis.

Effective Date: July 1, 2003; January 1, 2004.

Explanation of State Expenditures: The Department of State Revenue (DOR) would incur some administrative expenses relating to the revision of tax forms, instructions, and computer programs to incorporate the employer tax credit. These expenses presumably could be absorbed given the DOR's existing budget and resources.

Explanation of State Revenues: (Revised) The bill would reduce state Adjusted Gross Income (AGI) Tax, Insurance Premiums Tax, and Financial Institutions Tax liabilities of certain employers providing a health benefit plan to their employees for the first time. The bill also would reduce state AGI Tax liabilities of individual taxpayers who purchase health insurance through a cafeteria plan established by an employer as a result of this bill. However, a portion of this revenue loss could potentially be offset by increased revenue from the Insurance Premiums Tax due to the additional health insurance coverage being written in the state under these plans. The net revenue loss due to this bill could potentially range from \$846,000 to \$7.2 M in FY 2004 and \$1.5 M to \$9.2 M in FY 2005.

Adjusted Gross Income Tax Impact: The bill establishes a tax credit for an employer that makes health insurance available to employees through a *cafeteria plan*, provided the employer did not make health

insurance available to employees during the preceding year. The credit is equal to the lesser of: (1) \$500; or (2) \$200 plus \$10 per employee exceeding 20 employees. An employer claiming the credit must offer health insurance through a cafeteria plan for at least 24 consecutive months. The bill contains a “claw-back” provision for employers who fail to meet this requirement. The bill requires the cafeteria plan to be in compliance with Section 125 of the Internal Revenue Code. As a result, a qualifying cafeteria plan could include a *premium-only (cafeteria) plan*. This type of plan allows an employee to pay health insurance premiums by allocating their *pre-tax income* through a payroll deduction to the health insurance premiums. The income allocated by the employee is excluded from federal adjusted gross income and Indiana AGI as well. Thus, income that would otherwise be taxable (in the absence of the premium-only (cafeteria) plan) would no longer be taxable if used by the employee for health insurance premiums through the plan. The premium-only (cafeteria) plans do not require the employer to pay any share of the health insurance cost. The tax credit is nonrefundable, but may be carried forward to subsequent years. The tax credit may not be carried back by the taxpayer.

In addition to the employer tax credit, the bill requires Indiana employers that employ at least 25 full-time employees to make available to full- and part-time employees (and their dependents) at least one health benefit plan. This requirement takes effect beginning in 2004. The health benefit plan must be voluntary and must allow an employee to pay his or her share of the health benefit plan cost using a payroll deduction. The bill does not require the employer to pay any share of the cost of the health benefit plan. Given both provisions, the fiscal impact of this bill is a function of:

- (1) The number of employers currently not providing a health benefit plan to employees that would be required to do so under the bill.
- (2) The number of the employers described in (1) that would adopt a premium-only (cafeteria) plan both to comply with the insurance coverage mandate and to obtain the tax credit. Since the premium-only (cafeteria) plan appears to represent the minimum response available to the insurance coverage mandate, it is estimated that all the employers described in (1) would obtain the tax credit.
- (3) The number of employers exempt from the insurance coverage mandate (those with fewer than 25 full-time employees) that would establish a premium-only (cafeteria) plan and obtain the tax credit. It is important to note that employers with fewer than 25 full-time employees could potentially establish a premium-only (cafeteria) plan, obtain the tax credit, then eliminate the health benefit plan altogether after 24 months. Subsequently, the employer could wait one year, then establish a premium-only (cafeteria) plan for 24 months and again obtain the tax credit.

Recent survey results suggest that approximately 2,052 Indiana firms with 25 or more employees currently do not make a health benefit plan available to employees. The low range estimate assumes that: (1) Only these firms will establish cafeteria plans and obtain the tax credit; and (2) that 10% of the employees of these firms will allocate pre-tax income to payment of insurance premiums. It is assumed that the annual amount allocated per employee is equal to \$4,800 (or \$400 per month). Recent survey results indicate that the average monthly premium for employer-provided coverage is about \$250 for single coverage and \$660 for family coverage. These survey results also suggest that roughly 50,368 Indiana firms with fewer than 25 employees also do not make a health benefit plan available to employees. This group would be exempt from the insurance coverage mandate in the bill. However, the high range estimate assumes that: (1) these firms also will establish cafeteria plans and obtain the tax credit; and (2) that 10% of the employees will make the allocation for insurance premiums. Based on these two scenarios, the impact of the employer tax credit is estimated to range from \$340,000 to \$5.4 M in FY 2004 and \$424,000 to \$5.5 M in FY 2005 (due to changes

in quarterly tax payments). These estimates account for the year-to-year growth in firms established in Indiana as newly established firms would be eligible for the tax credit. Similarly, the impact of employee income allocated to newly established premium-only (cafeteria) plans is estimated to range from \$865,000 to \$3.1 M in FY 2004 and \$1.7 M to \$6.1 M in FY 2005 (due to lower withholdings). This impact would increase to the extent that employee participation rates exceed 10%. A 10% employee participation rate may be conservative given that recent survey results suggest that over 84% of workers in firms offering health benefits participate in the health plan.

Revenue from the AGI Tax on corporations, the Insurance Premiums Tax, and the Financial Institutions Tax is deposited in the state General Fund. Eighty-six percent of the revenue from the AGI Tax on individuals is deposited in the state General Fund, and 14% of this revenue is deposited in the Property Tax Replacement Fund.

Insurance Premiums Tax Impact: The bill could potentially increase revenue from the Insurance Premiums Tax as health insurance premiums written in Indiana increase due to the insurance coverage mandate and tax credit provided for under the bill. Based on the \$4,800 average annual allocation and 10% participation rate described above for premium-only (cafeteria) plans, the potential offset from the Insurance Premiums Tax could range from approximately \$359,000 to \$1.3 M in FY 2004 and \$670,000 to \$2.4 M in FY 2005 (due to changes in quarterly tax payments). These totals account for the potential that a few employees may make allocations for HMO premiums. HMOs do not pay the Insurance Premiums Tax. In addition, the Premiums Tax offset could be lower to the extent that insurance carriers are able to utilize more tax credits for assessments paid to the Indiana Comprehensive Health Insurance Association.

Revenue from the Insurance Premiums Tax is deposited in the state General Fund.

Explanation of Local Expenditures:

Explanation of Local Revenues: The bill could increase pre-tax allocations by employees to cafeteria plans for the purpose of paying health insurance premiums. This income would no longer be taxable and counties imposing local option income taxes (CAGIT, COIT, and/or CEDIT) may, as a result, experience an indeterminable decrease in revenue from these taxes.

State Agencies Affected: Department of State Revenue.

Local Agencies Affected: Counties with a local option income tax.

Information Sources: *Employer Health Benefits 2002 Annual Survey*, The Kaiser Family Foundation. *County Business Patterns - 1998, 1999, & 2000*, U.S. Census Bureau. *Section 125 Plan Design*, FennemoreCraig, September, 24, 2002. *Section (125) Premium Only Plan, Small Employer's Guide*, Corporate Benefit Services of America, Inc., January 1, 2000. *U.S. Master Tax Guide 2003*, paragraph 861.

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